APPENDIX "A"

MEMORANDUM DECISION BY BONSAL, D.J.
DATED JULY 9, 1973

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

GERRIT LANSING,

Plaintiff,

-against-

NEW YORK STOCK EXCHANGE,

Defendant.

Appearances:

FRANK DELANEY, ESQ.
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Attorney for Plaintiff

MILBANK, TWEED, HADLEY & McCLOY, ESQS.
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Attorneys for Defendant
RUSSELL E. BROOKS, ESQ.
MARTHA G. BANNERMAN, ESQ.
Of Counsel

MEMORANDUM

BONSAL, D.J.

At the end of plaintiff's case on May 23, 1973, the Court dictated findings of fact and conclusions of law, which are

reported on pages 427-439 of the transcript, and granted defendant New York Stock Exchange's motion to dismiss the complaint.

The following will supplement the findings and conclusions heretofore made:

Plaintiff instituted this action against defendant, New York Stock Exchange ("the Stock Exchange"), on July 12, 1968.

The action was brought to recover $77,000 in securities which plaintiff subordinated to the claims of creditors of the brokerage house of Pickard & Co., Inc. ("Pickard") and $250,000 in exemplary damages. The amended complaint alleges two causes of action — the first arising under the Securities Exchange Act of 1934 ("Act") (15 U.S.C. Sections 78a et seq.) and the second arising under the New York Penal Law.

All parties having waived a jury trial, this case was tried to the Court on May 21-23, 1973. At trial, plaintiff testified and called as witnesses: Mr. Edward Lill, a certified public accountant and a partner in the accounting firm of Haskins and Sells who supervised a surprise audit of Pickard in 1966; Mr. Robert Bishop, who, from 1966-68, was vice-president and director of the Department of Member Firms of the Stock Exchange; Mr. Joseph V. Shields ("Shields"), a former officer, director and shareholder of Pickard, who joined Pickard in 1963; and Colonel Thomas Magness, a retired army officer from Virginia who became a subordinated lender and non-voting shareholder of Pickard on July 28, 1967.

This Court has subject matter jurisdiction with respect to the Stock Exchange's alleged violation of the Act and of the rules promulgated thereunder, and with respect to the Stock Exchange's alleged violations of its duties under the Act and Rules. *Weinberger v. New York Stock Exchange*, 335 F. Supp. 139 (S.D.N.Y. 1971).

Plaintiff, a resident of New York City and a 1966 graduate of New York University, was a customer of Pickard, a member firm of the Stock Exchange. Pickard was formed in 1963 and was registered as a broker-dealer with the Securities and Exchange Commission until November 14, 1968 when its registration was revoked. During the relevant period, John Sackville-Pickard was president of Pickard, Peter Sackville-Pickard was vice president and secretary-treasurer, and Shields was executive vice-president. At the time of the commencement of this action, the Stock Exchange was an unincorporated association organized under the laws of New York. On February 18, 1971, the Stock Exchange was incorporated under the Non Profit Corporation Law of New York.

At all relevant times, the Stock Exchange was registered under Section 6 of the Act (15 U.S.C. §78f). Under this section, the Stock Exchange has certain regulatory duties with respect to its members, which it carries out through its Department of Member Firms. The Stock Exchange requires each member firm to employ an Auditor who makes a surprise audit of the firm each year at a time determined by the Auditor, and to be completed within thirty days. Following the audit, the Auditor fills out an "Answers to Financial Questionnaire" (the "Financial Questionnaire") and files it with the Stock Exchange. Within 30 days of the completion of the audit, the member firm must either send to its customers a customer statement, based on the surprise audit and which is a fair presentation of the data in the audit, or must inform them that a copy is available to them. A copy of the customer statement must be filed by the member firm with the Stock Exchange, where it is examined and reconciled with the Financial Questionnaire filed by the Auditor.

The Stock Exchange has established a trust fund, administered by trustees, to protect customers with respect to losses suffered by them in dealing with member firms.

Prior to June 1967, plaintiff had a custodian account with the

Bank of New York and, since 1964, the investments in the account were handled by Shields, at Pickard, whom plaintiff had known for many years. In early 1967, Shields suggested that plaintiff transfer his account to Pickard, becoming a subordinated lender, which meant that his account would be considered a part of the capital of the firm, and in return, plaintiff would get a 6% return on his account, in addition to dividends, interest and capital appreciation. Plaintiff could also enroll in Pickard's trainee program. Shields showed plaintiff two Statements of Financial Condition of Pickard, dated September 30, 1965 and October 31, 1966. The Statement dated October 31, 1966 was based on a surprise audit of Pickard conducted by Pickard's auditors, Haskins and Sells. This statement was filed with the Stock Exchange on February 20, 1967, and its examiners reconciled the Statement with the Financial Questionnaire filed by Haskins and Sells. The Statement dated October 31, 1966 contained two items whose legends were changed from the original audit. The "Receivable from officers" of $106,549.04 was changed to "Receivable from stockholders," and "Notes receivable from officers" of $218,041 was changed to "Notes receivable (guaranteed by stockholders)." Plaintiff conducted further investigations into Pickard including the reading of Dun and Bradstreet reports, and consulted with his attorney, Mr. Delaney, who met with Shields with respect to the subordination agreement.

Plaintiff transferred his account to Pickard, and on June 6, 1967 he executed a subordination agreement subordinating his account, which had a debit balance of $77,000. In connection with the subordination of his account, plaintiff purchased 100 shares of non-voting stock of Pickard at $100 per share. Plaintiff paid for this stock with a loan from Pickard secured by stock of Shell Oil Co.[1] Plaintiff also signed a financial supplement, dated

1. Shields told plaintiff that in order to become a 6% subordinated account lender, plaintiff had to purchase non-voting shares of Pickard pursuant to a requirement of the Stock Exchange.

June 6, 1967, to an application to the Stock Exchange to become a non-voting stockholder; a letter dated June 6, 1967, to the Stock Exchange agreeing not to encumber his non-voting stock; and a "knowledgeability" letter dated June 6, 1967, to the Stock Exchange, stating that he had investigated the financial condition of Pickard, that the Stock Exchange has no obligation to disclose any facts to plaintiff concerning Pickard, and that plaintiff would hold the Stock Exchange harmless on any claim against such firm. Plaintiff also signed an application dated June 13, 1967 to the Stock Exchange seeking its approval to become a non-voting stockholder of Pickard and a subordinated lender.

Plaintiff went to work for Pickard as a trainee in September of 1967, and in early 1968 received training to be a registered representative.

Prior to June 1967, the Stock Exchange instituted two disciplinary proceedings against Pickard. The first was instituted on January 11, 1966 for a violation of Rule 325 — the Capital Rule. The second proceeding was instituted on February 7, 1967 for a violation of the Capital Rule and with respect to the segregation of securities, and Pickard and its officers were censured and fined $5,000.

On October 25, 1967, Haskins and Sells began a surprise audit of Pickard, which they were unable to complete in late December or early January of 1968 due to the condition of the records at Pickard. This was reported to the Stock Exchange, and on or about January 26, 1968, Mr. Bishop called a meeting at the offices of Pickard at which all directors and voting stockholders were present, and informed those present that Pickard needed additional capital. By letter dated February 9, 1968, the Stock Exchange imposed certain restrictions on the activities of Pickard. By agreement dated February 13, 1968, the Stock Exchange agreed to help Pickard with its record keeping problems, and thereafter, employees of the Stock Exchange worked at Pickard. The Stock Exchange's trust fund advanced

money to Pickard and, in accordance with its prior agreement with Pickard, the Stock Exchange designated McChesney, its chief examiner, as liquidator of Pickard. On August 8, 1968, both John and Peter Sackville-Pickard were expelled from the Stock Exchange for fraud and misstatements, including improper redemption of stock, improper payments from Pickard to their wives, and the improper taking of loans from Pickard.[2]

In the amended complaint, plaintiff alleges that the Statement of Financial Condition dated October 31, 1966, on which plaintiff testified that he relied in subordinating his account, was materially false or "grossly or negligently inaccurate"; that the Stock Exchange knew that the Statement was false; and that the Stock Exchange aided and abetted Pickard in inducing plaintiff to subordinate his account. However, plaintiff has produced no evidence to support these allegations or to show that the Stock Exchange had any duty with respect to the Statement, which it did not discharge. The testimony indicates that the change in the legent from "officers" in the original audit to "stockholders" in the customer statement was immaterial since all the officers were stockholders.[3] Plaintiff testified that he did not inquire into the identity of the stockholders who were indebted to Pickard. See *List v. Fashion Park, Inc.*, 340 F.2d 456, 462 (2d Cir.), *cert. denied sub nom. List v. Lerner*, 382 U.S. 811 (1965); *Cohen v. Franchard*, ———F.2d——— (2d Cir. Apr. 11, 1973); *Lanza v. Drexel*, ———F.2d——— (2d Cir. Apr. 26, 1973).

2. One of these loans appears in the audited Statement of Financial Condition dated October 31, 1966 beside the legend "Notes receivable from officers" in the amount of $218,041. This inedbtedness arose out of an agreement dated June 16, 1966 in which John and Peter Sackville-Pickard took over the indebtedness of Anglo American Properties, Inc., a corporation controlled by them, and further agreed to secure the debt with stock of Pickards. A copy of this agreement was sent to the Stock Exchange. Anglo American Properties, Inc. went into bankruptcy.

3. Mr. Bishop testified that Pickard had nine stockholders and five officers, and that all of the officers were stockholders.

No evidence was presented at trial to show that the Stock Exchange violated the Act or Rules or any duties it assumed under the Act or Rules, and no evidence was produced to show that the Stock Exchange violated the New York Penal Law.

The foregoing constitutes the Court's findings of fact and conclusions of law. Rule 52(a), Fed. R. Civ. P.

Judgment in favor of the Stock Exchange dismissing the complaint may be entered accordingly.

s/D.B. Bonsal
U.S.D.J.

Dated: New York, N.Y. July 9, 1973.

APPENDIX "B"

JUDGMENT OF SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the twenty-eighth day of January, one thousand nine hundred and seventy-four.

PRESENT:

HON. STERRY R. WATERMAN
HON. WILLIAM H. MULLIGAN
Circuit Judges

HON. FREDERICK vP BRYAN,
District Judge

(SAME TITLE)

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed with costs to be taxed against the appellant.

A. DANIEL FUSARO, Clerk

VINCENT A. CARLIN
Chief Deputy Clerk

APPENDIX "C"

JUDGMENT OF SOUTHERN DISTRICT OF N.Y.

(SAME TITLE)

The issues in the above entitled action having been brought on regularly for trial before the Honorable Dudley B. Bondal, United States District Judge, on May 21, 22 and 23, 1973, and at the conclusion of the plaintiff's case, the defendant having moved the Court to dismiss the complaint, and the Court having granted the said motion, it is,

ORDERED, ADJUDGED AND DECREED: That the defendant, NEW YORK STOCK EXCHANGE, have judgment against the plaintiff, GERRIT LANSING, dismissing the complaint.

Dated: New York, N.Y.
May 24, 1973

s/Thomas E. Andrews
Clerk

6/19/73 — Appearance in opposition noted. Bill of Costs taxed in favor of the defendant in the amount of $293.50 and docketed as Jud. #73,542.

s/Raymond F. Burghardt
Clerk